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IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

No. 64.

AMY ARZT and JOSEPHINE RAMSEY,
Petitioners,

vs.

RUDOLPH B. FLERSHEM, CHARLES O. CORNELL, JOHN H. WATERS, et al., etc.

PETITIONERS' REPLY BRIEF.

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PETITIONERS' REPLY BRIEF.

I.

As to Bankers Trust Company's preliminary statement.

The respondent, Bankers Trust Company, in its brief (p. 2) objects to our statement (Main Brief, p. 5) that the Bankers Trust Company, as Trustee, approved in advance the omission of the payment of the February 1st, 1931, interest upon the outstanding debentures of the National Radiator Corporation. Our statement is based upon the testimony of John H. Waters. He testified as follows (R., 418):

"Q. When you sent out the notice on February 2, 1931, that is in evidence here as Exhibit 1, didn't you know at that time the company would be reorganized?

"A. Well, it is possible no doubt there had been discussions to that effect.

"Q. Did you consult with the Bankers Trust Company prior to default in the payment of interest?

"A. Consult them with reference to what?

"Q. That there would be a default in the payment of interest?

"A. I presume so.

"Q. Don't you know whether you did or not?

"A. Well, I rather apprehend we did, but I can't just recall what conversation there might have been.

"Q. *Did they acquiesce in default of payment of interest?*

"A. *I presume so, yes.*"

As to the part played by the Bankers Trust Company and Seligman & Company in the conferences preceding the passing of the interest and the appointment of the Reorganization Committee, Waters' testimony was as follows (R., 417):

"Q. Mr. Waters, when for the first time was the matter of the reorganization of the National Radiator Company first taken up?

"A. The reorganization of the National Radiator Company or Corporation?

"Q. The corporation.

"A. Oh, I presume that was in the latter part of 1930 it was discussed.

"Q. And who participated in that discussion?

"A. Well, some of the bankers who were interested.

"Q. Well, particularly, which bankers?

"A. The Bankers Trust Company. They were largely interested.

"Q. And what other bankers, if any?

"A. Seligman & Company. They were largely interested."

(R., 251):

"Q. How came it that the Reorganization Committee was organized?

"A. Well, due to the full knowledge of the affairs of the company of myself and Mr. Flershem, we realized that under the original capitalization it would not be possible to carry the organization to a safe conclusion, and we then went to the bankers in New York, Bankers Trust Company and Seligman & Company, the two factors in the consolidation of these six different companies, and suggested a reorganization with a reduced capitalization."

Waters and Flershem had already appointed themselve and Charles O. Cornell as the Reorganization Committee and apparently the decision to pass the interest had already been made when the board of directors of the National Radiator Corporation met on January 31, 1931, and ratified the action of its managing officers (R., 500) and passed the resolution to omit the payment of the February 1st, 1931, interest (R., 501).

The Bankers Trust Company may not excuse its participation in the reorganization of the corporation on the ground that it was the owner in its proper right of $1,040,000.00 of debentures (their Brief, p. 2). If it found its interest as holder of bonds to be in conflict with its duties as Trustee, it should either have sold the bonds or resigned from its trust.

Equally insufficient and unsatisfactory is the excuse now made that the acts performed by it at the bidding of the Reorganization Committee were mandatory upon it under the Indenture of its appointment.

Why did it remain passive from February 1st, 1931, until October 13th, 1931? It was not ignorant of the motives and designs of the Reorganization Committee. Why did it not appear in court and expose them in behalf of all the bondholders whom it now declares it represented? Why did it resist vigorously the intervention of the First National Bank of Cincinnati (R., 97-98)? Why did it not insist upon a fair appraisal of the assets by disinterested and impartial experts?

Why did it stand supinely by and permit $4,423,705.25 of current assets, of which almost $2,000,000.00 was in cash (R., 257-258; Main Brief, p. 18) and fixed assets which in 1927, when it sponsored the merger and sold the debentures were valued at upwards of $16,000,000.00 (R., 274) and which were carried on the books of the corporation **after depreciation** at $13,000,000.00 (R., 523), to be appraised at a paltry $2,300,000.00 (R., 153-154; 230; 231; 258-259) and to be sold as a going concern for $2,550,000.00 (R., 367; 375)? Why did it in its petition of intervention adopt wholeheartedly the complaint of the Reorganization Committee and join implicitly in its prayers for relief (R., 87; 92)?

> "* * * Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honestly alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the

rules of undivided loyalty by the 'disintegrating erosion' of particular exceptions. * * *"

Meinhard v. *Salmon*, 249 N. Y. 458, 464.

II.

Regarding some simple arithmetic.

A.

The statements in the brief of the Reorganization Committee (p. 3):

> "* * * that at the time the Receivers were appointed the defendant's cash was but little in excess of its interest and sinking fund obligations then due, totaling $1,094,429.50, and current liabilities of $157,511.89 (R., 295). * * *"

and (p. 5):

> "As already shown above, at the date of this receivership the defendant Corporation was indebted for interest and sinking fund payments and for current liabilities of $157,511.89 to a total of $1,251,941.39 and had this amount been paid it would have had cash left of only approximately $5,500."

are absolutely erroneous due to faulty arithmetic.

The total current debts of the National Radiator Corporation, when the receivers were appointed, did not exceed $900,000.00 (see Main Brief, p. 13). The sum then due for interest and sinking fund was not $1,094,429.50 but $741,464.19,—a mere difference of $352,965.31.

Interest upon the debentures was payable at the rate of 6½% on the first days of February and August in each year and on October 9th, 1931, when the receivers were appointed, the company was in arrears of two installments of interest (R., 9). If the whole $12,000,000.00 of debentures had been extant at that time, the interest would have amounted to $780,000.00, plus interest on that amount computed to October 9th. At that time, however, there were only outstanding $10,673,000.00 of debentures (R., 108) and the interest upon those debentures with interest thereon computed to October 13th, 1931 (when the Bankers Trust Company filed suit) amounted to $709,395.69, as set forth in the decree (R., 294).

On account of the sinking fund there was due then only the August 1st, 1931, installment which amounted to $201,918.50 (R., 108). As against that, the company had the right to deliver bonds (R., 279), for which under the Indenture it was entitled to credit at the redemption price (R., 279) of 107½ (R., 18). The company had on hand debentures in the principal amount of $158,000.00 (R., 108) which, at the redemption price, entitled it to credit of $169,850.00, leaving a balance due on account of sinking fund of only $32,068.50.

There is no dispute that there was due other creditors $157,511.89. But the aggregate of all the current debts including interest and sinking fund amounted to only $899,076.08. The company had on hand in cash at that time $1,257,381.59 (R., 521). Had it paid all of the obligations then due, there would still have remained in cash alone the sum of $358,305.51. That that amount was more than sufficient for the needs of the company is evidenced by the fact that immediately after their appointment the receivers invested $1,030,000—$130,000.00 more than the current liabilities—in United States and bank certificates of deposit (see Main Brief, p. 14).

B.

The statement in that brief (p. 3):

> "* * * With the maturity on February 1, 1932 of another installment of interest, the Corporation became completely insolvent in every sense of the word. * * *"

is also incorrect.

The interest for one-half year, to wit, from August 1st, 1931, to February 1st, 1932, upon $10,673,000.00 principal amount of debentures at the rate of 6½% per year, amounts to $346,872.50. To meet that interest payment there was about $600,000.00 additional cash.

On October 8th, 1931, the cash on hand amounted to $1,257,381.59 (R., 521). On December 31st, 1931, the cash or its equivalent amounted to $1,929,807.59 (R., 257) and on March 3rd, 1932 (R., 133), it amounted to $1,830,000.00 (R., 153-154; 155; 249). On February 1st, 1932, evidently, the company had on hand in cash or its equivalent about $600,000.00 additional with which to meet a payment of some $340,000.00 additional interest on the debentures.

C.

The statement in that brief that (p. 6):

> "* * * The properties themselves sold for $2,550,000, approximately 22% of the face amount of the Corporation's outstanding debt. * * *",

is misleading. Among the assets sold was cash (R., 297). So far as the Record discloses, the cash (including cash assets) in the possession of the receivers ranged from a high of $1,929,807.59 on December 31, 1931 (R.,

257), to a low of $1,570,852.15 on June 30, 1932 (R., 523) and approximately a like amount on the day of the sale, August 8, 1932 (R., 401-402). Thus the cash and cash assets themselves represented about 18% of the total debts on December 31, 1931, and about 14% on August 8, 1932, and the price realized for the assets of the company, exclusive of cash, ranged from a high of about 8% to a low of 4%.

Since the respondents are dealing with percentages, we will indulge in a few of our own.

On December 31, 1931, as of which date the assets were appraised for the upset price, there was on hand (R., 257-258; Main Brief, p. 18):

Current assets	$4,423,705.25
Included in that was cash, which we will deduct, amounting to	1,929,807.59
Leaving current assets, exclusive of cash, in the sum of	$2,493,897.66

The other assets of the company, such as plants, machinery, equipment, patents, etc., amounted to upwards of $13,000,000.00 (R., 523), making a total of assets, exclusive of cash, of $15,493,897.66. The upset price was fixed at $2,500,000.00, or roughly $600,000.00 above the cash on hand. All of the assets, current and fixed, were therefore appraised at less than 25% of the current assets, exclusive of cash, and at about 4% of the total assets, also exclusive of cash.

When the respondents speak of 22%, they do not take into account that out of that 22% there will have to be paid (R., 309-310): (1) all administration expenses, allowances and disbursements of the receivership, including the expenses of the sale; (2) the compensation and disbursements of the complainants and of their solici-

tors, and of the National Radiator Corporation, of its solicitors, and of the solicitors for the receivers in this cause; (3) the compensation of the Bankers Trust Company, its attorneys, and expenses and liabilities incurred by it; (4) all unpaid indebtedness and liabilities of the receivers; (5) the compensation of Robert H. Richards, Jr., one of the receivers appointed by the Chancery Court of the State of Delaware; and (6) the compensation and disbursements in the various ancillary suits. After all those expenses are paid, what will be left for non-assenting creditors is only problematical. We venture to say that unless this Court holds that as to non-assenting creditors, the decrees of the District Court are void and a nullity, non-assenting creditors would have fared far better if on March 3rd, 1932, when hearings for the purpose of fixing the upset price were held, they had accepted their distributive share of the $1,812,894.00 of cash then on hand (R., 249) (which represented about 17% of the total liabilities), and had renounced their right to share in the other assets of the company.

III.

The plan did not meet with the wholehearted support of the debentureholders. Many were coerced into it.

The Reorganization Committee in their brief (pp. 9-10) state as follows:

> "This suit really represents a two years' effort on the part of the great body of creditors to take over the corporate property for themselves. Their efforts have not been opposed by the Corporation, but strenuous resistance has come from a few creditors. Except for the obstruction by these few creditors, the overwhelming majority of the creditors

would long ago have taken over all of the corporate assets; they would have been in control of the management, and they would constitute the New Company. * * *"

The implication is and those respondents would have it appear that this reorganization was undertaken in the interest of debentureholders, that it met with their wholehearted support and that they will be in control of the new company.

The fact, however, is that the reorganization was initiated by the Waters family, undertaken in the interest of the Waters family, and that the Waters family will be in control of the new company. A great many debentureholders were opposed to the reorganization but were coerced into it.

On October 7th, 1931 (R., 110) there were deposited under the plan $8,763,000.00 principal amount of debentures. There were at that time outstanding principal amount $10,673,000.00 and holders of $1,890,000.00 objected to the plan and refused to deposit thereunder. Upwards of $851,000.00 of these debentures were deposited with the Protective Committee which sold out to the Reorganization Committee for the sum of $35,000.00 (Main Brief, pp. 8-9); the others showed their disapproval of the plan by refusing to deposit with either committee.

What is therefore quite plain is that the Reorganization Committee, by their suit, accomplished what they set out to do; they had coerced into subjection to the plan all bondholders except a few, who now appeal to this Court for relief.

As to control of the new company, that will be vested not in the debentureholders, but in the Waters family. Evidence of that fact is contained in the statement which appeared in the November 28th, 1931, minutes of the Reorganization Committee (R., 520):

"* * * It was the sense of the meeting that said Board of Directors (of the new company) should consist of twelve members, one of whom would be Mr. Frank B. Cahn and that the remaining members should be persons satisfactory to Mr. Waters and of his nomination, to the extent that circumstances did not require the inclusion of any others."

IV.

Original lack of jurisdiction was not cured by the intervention of Bankers Trust Company.

The statement in the brief of Bankers Trust Company (p. 5) that its petition of intervention—after recovery of judgment—might be regarded as an original creditor's bill and thus the original lack of jurisdiction be cured, is erroneous. In our Main Brief (p. 35) we pointed out that such a contention is untenable under the rule in *Pusey & Jones Co.* v. *Hanssen*, 261 U. S. 491.

A similar contention was made and overruled by this Court in *United States ex rel. Texas Portland Cement Company* v. *McCord*, 233 U. S. 157. In that case this Court said at page 163:

"* * * These rights to intervene and to file a claim, conferred by the statute, presuppose an action duly brought under its terms. In this case the cause of action had not accrued to the creditors who undertook to bring the suit originally. The intervention could not cure this vice in the original suit. Nor do we think that the intervention could be treated as an original suit. No service was made or attempted to be had upon it, as required by the statute when original actions are begun by creditors. *As we read the certificate, the intervention was what it*

purported to be, an appearance in the original suit, already brought, and in our view must abide the fate of that suit.'' (Italics ours.)

V.

The contention of the respondents, Reorganization Committee, that the original lack of jurisdiction was cured by the alleged subsequent insolvency of the National Radiator Corporation is not tenable either in fact or in law.

The respondents, Reorganization Committee, seek to sustain the jurisdiction on the ground (Brief, p. 11):

> ''* * * that by February 1, 1932 and ever thereafter, the Corporation was in fact utterly insolvent in every sense of the word;''

That contention is not tenable either in fact or in law.

First, the company was not insolvent on February 1st, 1932. Even at that date it had in cash alone more than enough with which to pay the debts which it had permitted to accumulate. The assumption of insolvency proceeds from errors of arithmetic (supra, pp. 5-6). Nor is there any proof of insolvency at any time thereafter. That assumption is wholly gratuitous.

But if, **for the sake of argument,** we say that at some time after the appointment of the receivers the company would or did reach the point where the cash was insufficient to pay all the obligations which had been permitted to accumulate, isn't it probable that if no receivers had been appointed and no accumulation had been permitted, that that condition could have been avoided? Receivership is not the least expensive nor the most efficient method of doing business and a company in the process of reorganization is not most profitable.

A comparison of the condition of the company for the period from December 31, 1930, to June 30, 1932, may be more convincing upon that point than argument. During the first nine months of that period the company was not in receivership; during the latter ten months it was.

The financial statement of the company on December 31, 1930 (which was the last before the receivership), showed current assets at $5,054,007.37 (R., 34). A statement prepared by the receivers showing the condition of the company as of October 8th, 1931 (R., 402) one day prior to their appointment, showed current assets at $4,939,727.54 (R., 521-522, Main Brief, p. 12), a shrinkage of current assets during that nine months' period of only $114,279.76. That was due solely to the unusually heavy reserve of $179,046.79 for bad debts; a reserve in excess of 10% of $1,673,373.59 of notes and accounts receivable, whereas the previous rate charged for such reserve was only 3% (R., 208; 210; 211). If the usual deduction for such reserve had been made, the company would have shown no shrinkage of current assets whatsoever.

The receivers entered into possession on October 9th, 1931, and on January 2nd, 1932 (R., 82) they rendered a report for the period from October 9th, 1931, to and including November 30th, 1931 (R., 85). That report showed an operating profit of $31,817.44, before depreciation on plants, etc. (which, of course would not affect current assets), and a loss of $14,630.44 after an allowance of $46,548.21 as an expense for the maintenance of non-operating plants (R., 85).

The receivers' statement of current assets as of December 31, 1931 (R., 257-258, Main Brief, p. 18) shows a drop of current assets to $4,423,705.25, a shrinkage in current assets of $516,022.29, although the months of October, November and December are the best months in that line of business (R., 233-238).

Equally interesting is the receivers' statement of current assets on June 30th, 1932 (R., 523). That statement shows current assets at $3,883,847.23, a further shrinkage of $539,858.02.

No explanation for the dwindling of current assets of upwards of $1,000,000.00 during the ten months of operation by the receivers is contained in the Record (R., 404). The entire shrinkage of over $1,000,000.00 (before depreciation and before interest on debentures) cannot be attributed to losses. Over $500,000.00 of that shrinkage occurred between October 9th and December 31, 1931, and for two of those months the operating loss after an allowance of expenses for carrying idle plants, was only about $14,000.00 (R., 85). It is inconceivable that a loss of $500,000.00 was sustained in December, 1931.

Perhaps there had been an undervaluation of current assets; perhaps the reserves which were set up were too high.

In any event the receivers were not as successful in the operation of the company as were the company's own management. At least, that was the contention made by the respondents. They objected to a stay of the transfer of title to the new company pending appeal on the ground "that this delay to the estate would be approximately $50,000.00 a month" (R., 402). It was their contention that transacting business through receivership imposed additional hardships upon the corporation which, translated into money, amounted to $50,000.00 a month.

But despite the impediments of receivership, the accumulation of interest, the unexplained shrinkage of current assets, the corporation on August 8th, 1932, the day of the sale, could have paid the $1,440,882.08* of accumulated and unpaid interest upon the outstanding

*Figure taken from Respondents' Brief, page 3.

debentures out of the approximately $1,551,615.78 then in its possession (R., 401-402) and still have had more than $100,000.00 with which to transact business.

Secondly, the respondents' proposition is not tenable in law.

In *American Bonding & Trust Co. v. Gibson County*, 145 Fed. 871, Lurton, C. J. (later Mr. Justice), says at page 874:

> "Plaintiff's right to any recovery depended upon its right at the inception of the suit, and the non-existence of a cause of action when the suit was started is a fatal defect, which cannot be cured by the accrual of a cause pending suit. * * *"

See also:

Hollingsworth v. *Flint*, 101 U. S. 591.

The case of *Brown* v. *Lake Superior Iron Company*, 134 U. S. 530, cited by the respondents does not support their contention. In that case, the corporation was insolvent and upon bill filed by some of its creditors, acquiesced in the appointment of receivers. Nine months after the appointment it prayed for a dismissal of the bill on the ground that the plaintiffs had complete and adequate remedies at law.

This Court in that case held that jurisdiction of the subject matter of the suit existed and that by acquiescing in the appointment of receivers, it had waived the right to that defense.

In that case this Court said at page 536:

> "* * * This matter has recently been before this court, in *Reynes* v. *Dumont*, 130 U. S. 354, 395, and was carefully considered, and the rule, with its limitations, thus stated: 'The rule as stated in 1 Daniell's Chancery Practice, 555, 4th Am. ed., is, that if the objection of want of jurisdiction in equity is not taken in proper time, namely, before the defend-

ant enters into his defense at large, the court, having the general jurisdiction, will exercise it; and in a note on page 550, many cases are cited to establish that 'if a defendant in a suit in equity answers and submits to the jurisdiction of the court, it is too late for him to object that the plaintiff has a plain and adequate remedy at law. This objection should be taken at the earliest opportunity. *The above rule must be taken with the qualification that it is competent for the court to grant the relief sought, and that it has jurisdiction of the subject matter.*' • • • It was held in *Lewis* v. *Cocks*, 23 Wall. 466, that if the court, upon looking at the proofs, found none at all of the matters which would make a proper case for equity, it would be the duty of the court to recognize the fact and give it effect, though not raised by the pleadings, nor suggested by counsel.' • • •" (Italics ours.)

In the case at bar, the objection to the jurisdiction is made not by the debtor corporation but by creditors who protest that the judgment is collusive and that the court never had jurisdiction of the subject matter of the suit and ask that as to them it be adjudged a nullity.

International Life Insurance Company v. *Sherman*, 262 U. S. 346.

Conclusion.

We have not been able to find, nor have the respondents referred us to a single case in which a receiver was appointed of a corporation which was not insolvent within either one or the other of the definitions of insolvency. In all cases which we have found or the respondents have cited, either the corporation was insolvent within the

definition of the Bankruptcy Act or else it was hopelessly unable to meet and pay its debts as they matured in regular course.

It is our contention that a court of equity may not take jurisdiction of a going solvent corporation for the purpose of reorganizing it, even though its operation is unprofitable. We do not deny to the corporation and to assenting creditors the right to reorganize such a corporation. But we contend that reorganization should be and can be only without prejudice to the rights of non-assenting creditors and without fraud upon them.

Such reorganization is binding upon those who assent thereto but not upon others.

Canada Southern Railway Company v. *Gebhard*, 109 U. S. 527.

Gilfillan v. *Union Canal Company*, 109 U. S. 402.

It is not our purpose nor desire to disrupt the reorganization. We merely ask that it be declared not binding as to those who have not assented thereto.

We therefore respectfully submit that the decrees of the Circuit Court of Appeals and of the District Court should be reversed and adjudged void as to creditors and debentureholders who have not assented to the plan of reorganization.

Respectfully submitted,

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